

**SUBMITTED ELECTRONICALLY**

April 15, 2013

The Honorable Dave Camp  
Chairman  
Committee on Ways and Means  
United States House of Representatives  
1102 Longworth House Office Building  
Washington, DC 20515

The Honorable Sander Levin  
Ranking Member  
Committee on Ways and Means  
United States House of Representatives  
1106 Longworth House Office Building  
Washington, DC 20515

The Honorable Vern Buchanan  
Small Business & Pass-Throughs Working  
Group  
Committee on Ways and Means  
United States House of Representatives  
2104 Rayburn House Office Building  
Washington, DC 20515

The Honorable Allyson Schwartz  
Small Business & Pass-Throughs Working  
Group  
Committee on Ways and Means  
United States House of Representatives  
1227 Longworth House Office Building  
Washington, DC 20515

**RE: Flow-Through (Pass-Through) Tax Treatment of Partnerships is a Well-Established U.S. and International Tax Principle That Should Be Maintained Regardless of the Size of a Business**

Dear Chairman Camp, Ranking Member Levin, Congressman Buchanan, and Congresswoman Schwartz:

This letter is submitted by the Private Equity Growth Capital Council (“PEGCC” or “we”, as applicable) in response to the Ways and Means Committee’s invitation to provide comments on various aspects of tax policy as the Committee and its Working Groups weigh options for comprehensive tax reform. The PEGCC is an advocacy, communications and research organization established to develop, analyze and distribute information about the private equity and growth capital investment industry and its contributions to the national and global economy.<sup>1</sup>

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<sup>1</sup> Established in 2007, and formerly known as the Private Equity Council, the PEGCC is based in Washington, D.C. The PEGCC’s members are 34 of the world’s leading private equity and growth capital firms united by their commitment to growing and strengthening the businesses in which they invest. The members of the PEGCC are: ACON Investments; American Securities; Apollo Global Management LLC; ArcLight Capital Partners; The Blackstone Group; Brockway Moran & Partners; The Carlyle Group; CCMP Capital Advisors, LLC; Crestview Partners; The Edgewater Funds; Genstar Capital; GTCR; Hellman & Friedman LLC; Highstar Capital; Irving Place Capital; The Jordan Company; Kelso &

## **Introduction**

The PEGCC supports reforming the nation's tax code, where appropriate, to encourage greater entrepreneurship, investment, capital formation, job creation and economic growth. Precisely because of this position, as described in more detail below, we support maintaining the current flow-through (pass-through) taxation structure for businesses organized as partnerships, limited liability companies, S Corporations, and sole proprietorships. To this end, we respectfully submit this letter for your review.

Businesses organized as partnerships, limited liability companies, S Corporations, and sole proprietorships account for more than half of all jobs in the United States, employing more workers than C Corporations in almost every state. Historically, the Internal Revenue Code has always afforded these entities flow-through (pass-through) tax treatment, and this policy has been adopted as an international norm. Accordingly, any change to this accepted tax treatment for certain business enterprises could have a markedly harmful impact on job creation and economic growth in a substantial subset of the U.S. private sector.

Proposals to tax large flow-through (pass-through) entities as C Corporations, thereby adopting multiple layers of taxation for these entities, would introduce substantial uncertainty into the Tax Code, distort organizational choice, and disincentivize entrepreneurial growth. By prioritizing revenue generation over traditional objectives of sound tax policy such as neutrality and simplicity, these proposals would undercut 30 years of federal policy designed to expand the use of flow-through (pass-through) business forms and compromise a system that currently provides workable and efficient alternatives for entrepreneurs forming a business.<sup>2</sup>

Prescribing differing tax treatments for flow-through (pass-through) entities based on their size would fundamentally misalign economic incentives for new and growing businesses. Setting a threshold above which a flow-through enterprise would be taxed as a C Corporation creates a substantial disincentive for businesses to grow beyond a level at which their profits are subject to only one layer of taxation. Simultaneously, such a policy would create new incentives for tax avoidance by dividing large flow-through (pass-through) entities into smaller business units that would escape double taxation.

Moreover, adopting a double tax structure for large flow-through (pass-through entities) would create a federal policy preference for C Corporations, amidst growing consensus that the Internal Revenue Code should reflect a single tax layer for *all* business enterprises. Republican and Democratic witnesses have testified before the Ways and Means Committee that it makes more sense for C Corporations to pay one level of tax than for flow-through (pass-through) entities to pay two levels of tax. Congress should encourage policies that move all forms of business to one level of taxation, not the other way around.

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Company; Kohlberg Kravis Roberts & Co.; KPS Capital Partners; Levine Leichtman Capital Partners; Madison Dearborn Partners; MidOcean Partners; New Mountain Capital; Providence Equity Partners; The Riverside Company; Silver Lake; Sterling Partners; Sun Capital Partners; TA Associates; Thoma Bravo; TPG Capital (formerly Texas Pacific Group); Vector Capital; Vestar Capital Partners; and Welsh, Carson, Anderson & Stowe.

<sup>2</sup> See Philip F. Postlewaite, "Raising Revenue Through Misguided Classification Reform," *Tax Notes*, September 3, 2012.

## **Private Equity Background**

To place this important policy discussion in context, we would like to provide a description of the structure and operations of private equity firms and private equity funds:

### *Private Equity Firms*

Private equity firms sponsor, manage and advise private equity funds (which are described below). Private equity firms, or the owners of private equity firms, typically own and control their funds' general partners (or, in the case of a fund that has a non-partnership structure, the equivalent controlling entity), which make investment decisions for the fund. Private equity firms most frequently are privately owned and controlled by their senior investment professionals.

There are more than 2,600 private equity firms in the U.S. In 2012 alone, private equity firms invested \$313 billion in more than 1,800 U.S. based companies. There are more than 15,300 companies in the United States that are backed by private equity investment. Private equity-backed U.S. companies employ approximately 8.1 million people worldwide.

### *Private Equity Funds*

Private equity funds are partnerships formed to acquire large (often controlling) stakes in growing, undervalued or underperforming businesses. Private equity funds seek to structure the management and operations of the acquired businesses to grow and strengthen the businesses over the long-term. Many years later, private equity funds realize the increased value they have created by disposing of their interests in the acquired businesses. Outside investors, including pension funds, endowments, and corporate and individual investors (the "limited partners") generally contribute 90 to 97% of the equity capital used to acquire the businesses. The sponsor of the funds (the "general partner") provides the remaining 3 to 10% of fund capital. Investors generally cannot freely dispose of their interests in the funds. Their interests are liquidated as the fund disposes of the underlying investments, a process which generally takes 10 to 12 years from the fund's inception.

## **Flow-Through (Pass-Through) Taxation in the Private Equity Context**

Changes to the current flow-through (pass-through) tax structure for private equity firms organized as partnerships would diminish competition and capital formation in the industry by effectively subjecting these entities to triple taxation. Since most of the companies owned by private equity partnerships (i.e., portfolio companies) are typically organized as C Corporations, they are already subject to double taxation. A policy adopting C Corporation treatment for private equity partnerships would create a third level of taxation, increasing the overall tax rate for private equity investments by at least 10%. This new entity-level tax on flow-through (pass-through) entities would make these businesses less competitive in the global economy and create new barriers to entry for emerging funds.

## **Partnerships and S-Corporations Should Remain Subject to a Single Layer of Taxation**

In summation, we urge the Ways and Means Committee to maintain the current flow-through (pass-through) taxation of partnerships and S Corporations. Flow-through businesses have already seen their taxes increase in 2013. This year, the top rate paid by these businesses has risen significantly. We encourage members to avoid unfairly targeting large flow-through (pass-through) entities for additional tax increases in the context of comprehensive tax reform. Flow-through (pass-through) taxation should remain the norm for *all* partnerships and S Corporations.

The PEGCC appreciates the Committee's consideration of this submission and is available to discuss any questions that the Committee may have.

Respectfully submitted,



Steve Judge  
President and CEO  
Private Equity Growth Capital Council